

DAUGHTERS & RYAN, INC.

State Excise Tax Collection for Internet /Mail Order *Problem Analysis and Outline, February, 2005*

UNDERLYING ASSUMPTIONS/PREREQUISITES

- The Federal Government will strengthen enforcement of the Jenkin's Act for cigarettes, but will continue to exclude all OTP (not just cigars and pipe tobacco).
- Some states will go beyond the Jenkin's Act and regulate against tobacco sales of any kind into their states (except perhaps cigar and pipe tobacco).
- The following discussion of possible excise collection mechanisms is intended for those states that would allow Internet/mail order sales if adult signature verification were certified and excise taxes were collected.

MAIN PROBLEM

- Internet and Mail Order cigarette/OTP sales are not monitored/regulated.

RELATED PROBLEMS

- Lower prices for Internet/mail order tobacco products fail to elicit the desired consumer reaction of reduced consumption. (A significant effect of increased prices from the MSA is reduced smoking overall).
- Possible source for youth access to tobacco products.
- State Excise taxes are not collected.
- State Sales taxes are not collected.
- NPM sales are not recognized for escrow purposes.
- Criminal activity (possible terrorist) is rewarded and funded from enhanced profitability.
- Some states may regulate the problem in a manner that generates unintended consequences, and thereby creates more criminal incentives and underground activity.
- Honest, hard working and responsible citizens may be inclined to seek the lowest priced tobacco products and become involved in unlawful activity. (Perhaps millions of citizens).
- A growing number of tobacco manufacturers are created (who exploit this opportunity) which requires ever more supervision by the TTB.
- The Jenkin's Act is not currently enforced.
- The USPS does not presently offer an adult signature verification service. (UPS has recently added this service).

DISCUSSION OF KEY ISSUES AND SYSTEM COMPONENTS/CONSIDERATIONS

- **Licensing Authority/Locus of Control.** Certified Internet/Mail stores could be licensed/registered at a national level with one organization, or by the participating states at a state by state level.
- **Collection, Administration and Enforcement.** A national center for “state” excise tax collection, verification and administration could be established. Alternatively, a model employing collection centers in every state could be developed. Monitoring and enforcement could also be at either a national or state level.
- **Distribution of Excise Taxes.** Under a national system of collection, collected excise taxes could be distributed based on actual invoice amounts or by an imputed estimate (as in the MSA). Under a state model, after the original sale into a respective state, how will subsequent sales into secondary states be regulated/reported?
- **Possible Integration with Other Issues.** NPM sales through internet and mail order channels are not currently reported for escrow purposes. An Internet/Mail license might link with NPM reporting requirements and facilitate NPM escrow verification/compliance. A successful excise tax collection/distribution system might even serve as a model for capture of sales taxes from internet/mail order sales, future SPM brand certifications, or other state and federal tobacco initiatives.

ALTERNATIVE COURSES OF ACTION

- **Do nothing.** The states could continue to allow the current “wild west” environment to persist and regulate the problem in a hodge podge manner without coordination.
- **Consumer Reporting Based.** The states might pursue a reporting/collection mechanism based on the honesty of consumers to provide state excise taxes from internet/mail sales. If the behavioral pattern mirrors voluntary sales tax reporting, I suspect most of the funds will go unreported. In response, some states may try to impose draconian reporting requirements on internet/mail stores to “rat out” their customers. Support by stores will be non-existent as this will be perceived as a violation of customer trust. (We would be reluctant to provide any customer information to any state for any purpose). This alternative would alienate millions of Americans and generate huge amounts of anti-government hatred. Most people will circumvent government efforts and criminal activity will proliferate.
- **Issue State Internet/Mail Licenses.** The states could issue an Internet/Mail license for the reporting/collection of excise taxes directly from the stores at the time of the transaction. The tax would have to be low enough to garner support from customers and Internet/Mail stores, yet high enough to still gain support from the states. Excessively high excise taxes in some states will cause people to devise means to avoid payment and criminal activity will flourish.
- **Issue National Internet/Mail Licenses.** A cooperative collection and enforcement mechanism could be developed which minimizes “state shopping” for tobacco products. Coordinated enforcement would help identify criminal activity at a lower cost to the states.

SUGGESTED COURSE OF ACTION/OUTLOOK FOR THE FUTURE

After attending the Burlington, Vermont triennial meeting last year, I am impressed by the motivation and dedication of participants and am resultantly confident that the states and manufacturers could work together and solve the Internet/Mail order issue. Although the task of developing an excise tax collection mechanism would be the responsibility of the state attorneys general, and I would not want to tread on their domain, I suggest that some type of Internet/Mail order license is essential. A combination/hybrid of a national and state model could be developed which directs consumers toward lawful compliance without creating incentives to circumvent the system and stimulate criminal activity. Administrative and financial feasibilities must also be analyzed to ensure compliance by the Internet vendors and effective operation by the states. My optimism is somewhat tempered by a concern that a rogue state will go off on an aggressive direction and undermine the system with adverse incentives and catastrophic unintended consequences. I also recognize that some AG's do not want any tobacco products of any kind in their state. (I personally find a paternalistic reaction by some well-intentioned leaders to be potentially dangerous and contrary to American principles of personal responsibility/accountability, individual freedom/volition, and behavioral changes by education, not intimidation/coercion). Furthermore, from past interactions with attorneys general I understand that all states do not have the same amount of resources to pursue a tobacco agenda independently. With some sense of trepidation related to these concerns, I remain hopeful that the "rational mind" will prevail. I am also reluctant to recommend active participation by NAAG. In the six years since the MSA was signed, NAAG has not defined a Mission statement related to tobacco issues, has been unable to define the term "dispute" for the Independent Auditor, and has failed to provide coordination and facilitation for the states to improve enforcement efficiencies. I recommend that the states follow a standard strategic planning model to develop a comprehensive mechanism to address tobacco issues at a coordinated national level. Possible steps in this process are as follows:

- **Establish a Steering Committee.** Form of group of five to ten members composed of attorneys general and tobacco manufacturers. The main purpose of the steering committee is to organize and recruit the task force, formulate a Mission statement, and to facilitate and coordinate a "tobacco issues partnership/coalition".
- **Perform a Tobacco Issues Assessment.** The steering committee would survey the state AG's, tobacco manufacturers, health care providers, Internet/mail vendors, and other government agencies (TTB, FTC, etc.) to identify key issues (including state excise tax collection).
- **Convene the Tobacco Partnership/Coalition.** Select a group of forty to fifty people who represent a broad spectrum of those affected by tobacco issues. The coalition should also include consumers and members from diverse socioeconomic and ethnic groups. Findings of the tobacco issues assessment should be presented and key issues may be organized into five to eight strategic categories. These main strategic categories will form the basis for establishing sub-committees and related objectives. Broad committee goals are formulated.
- **Develop Action Plans.** The sub-committees meet monthly (or quarterly, depending on the timeframe for milestone accomplishment) to develop/implement action plans. The plan of action will provide detailed steps for the accomplishment of the broader based goals. Subcommittee chairmen will meet quarterly/semi-annually with the Steering Committee (a kind of executive committee) to report progress, seek guidance, and inform the public of achievements. Convene annual meetings to assess objectives and effectiveness.